Board of Taxation

Review of the legal framework for the administration of the Goods & Services Tax

Submission by
Greenwoods & Freehills

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andrew.howe@gf.com.au

rhys.penning@gf.com.au

Greenwoods
& Freehills

Greenwoods & Freehills Pty Limited ABN 60 003 146 852 incorporating Shaddick & Spence

MLC Centre Martin Place Sydney NSW 2000 Australia Telephone +61 2 9225 5955 Facsimile +61 2 9221 6516
GPO Box 4982 Sydney NSW 2001 Australia www.gf.com.au DX 482 Sydney

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Introduction

Greenwoods & Freehills Pty Limited is a specialist tax practice - Australia's biggest advisory firm practising exclusively in revenue laws.

This paper sets out our submission to the Board of Taxation for its "Review of the legal framework for the administration of the Goods & Services Tax". We set out in this submission sixteen recommendations to improve the operation of the GST which would reduce compliance costs (for taxpayers and the Tax Office) and remove anomalies. The recommendations are based on the day to day issues we experience through advising large corporate taxpayers on transactions and GST compliance. The recommendations respect, and in most cases improve, the integrity of the GST regime as a multi-stage, value added tax.

Andrew Howe
Director
Greenwoods & Freehills

+61 2 9225 5919
+61 414 641 438
andrew.howe@gf.com.au

Rhys Penning
Director
Greenwoods & Freehills

+61 3 9288 1910
+61 402 119 717
rhys.penning@gf.com.au

1 GST registration of non-residents

1.1 Issue

With reference to the Board of Taxation's question 1.6[1], Division 57 of the GST Act makes resident agents acting for non-residents responsible for the GST consequences of what the non-residents do through their resident agents but does not exempt non-residents from being required to register for GST even though their resident agent is liable for GST and entitled to input tax credits in respect of supplies and acquisitions made through the agent.

1.2 Proposed Solution

We recommend that a specific sub-section be added to Division 57, similar to section 83-25, providing that non-residents are not required to register for GST purposes where they would not meet the registration turnover threshold but for the supplies made through a resident agent.

1.3 Analysis

There are special rules under Division 57 of the GST Act which make resident agents acting for non-residents liable for the GST payable on taxable supplies and taxable importations made by the non-resident through the resident agent. Furthermore, the resident agent would be entitled to claim input tax credits for any creditable acquisitions or creditable importations made by the non-resident through the resident agent.

In our view, there appears to be an anomaly in the GST law which still requires a non-resident which makes all of its taxable supplies through a resident agent (pursuant to Division 57) to register for GST notwithstanding that they would not be liable for GST in respect of the supplies made through the resident agent. That is, there is no specific exclusion in either Division 23 or Division 57 for non-residents to register for GST in such circumstances. However, we note that the non-resident would not be required to lodge periodic GST returns if the only taxable supplies that the non-resident makes are supplies made through a resident agent[2].

Even though there is no GST return for such non-residents to lodge, an entity that does not register for GST where it is required to do so is liable for an administrative penalty of $2,200 under section 288-40 of Schedule 1 of the *Taxation Administration Act 1953*.

The removal of the need for a non-resident to register for GST purposes is already recognised in Division 83. In that division, where a resident recipient agrees with a non-resident supplier to "reverse charge" the GST that the supplier would otherwise be liable to pay, then the non-resident recipient is also relieved from registering for GST purposes[3].

In our view, a non-resident that makes all their supplies and acquisitions through a resident agent should not be required to register for GST. Such GST registration imposes an additional compliance burden on non-residents doing business in Australia for no apparent benefit.

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[1] Question 1.6 asks: Do the current arrangements for resident agents acting for non residents and the voluntary reverse charge mechanism operate effectively to enable their use by non-resident entities? If not, how could their operation be improved?

[2] section 57-40

[3] section 83-25 provides the non-resident "need not apply to be registered" if the supplies that make it exceed the registration threshold are reverse charged under Division 83.

2 Exclude tax law partnerships as a deemed entity

2.1 Issue

With reference to Board of Taxation question 2.2[4], the GST law does not operate clearly or effectively in deeming tax law partnerships (TLPs) to be an entity for GST purposes - it should ignore TLPs and each co-owner should deal with its own GST payments and compliance.

2.2 Proposed Solution

To effect this solution, it is only necessary to change the definition of "partnerships" for GST purposes in section 195-1 to cover "general law partnerships" only, as follows"

> "*partnership means an association of persons (other than a company) carrying on business as partners*".

2.3 Analysis

A "tax law partnership" is "an association of persons ... in receipt of ordinary income or statutory income jointly". The "association" is defined as a "partnership for income tax purposes but is not recognised as a "partnership" at law, nor is it any other sort of legal entity. It is, in this regard, deemed to be an entity for income tax purposes.

However, despite being deemed to be an entity for income tax purposes, the entity is effectively ignored for income tax purposes due to the Commissioner's administrative practice of not requiring a tax law partnership to submit partnership returns.

Currently GST law includes TLP's as an entity as Division 184-1 includes a "partnership" as an entity for GST purposes, and "partnership" for GST purposes is defined in section 195-1 to have the meaning given in by section 995-1 of the Income Tax Assessment Act 1997.

Difficulties - practical and technical - have arisen in treating the income tax fiction as an entity for GST purposes, especially as it is an entity legally and effectively ignored for income tax and accounting. Technical difficulties include whether a TLP has "capital"[5], whether the supply of the assets can be the supply of "an interest in the capital of a partnership" (which is input taxed for GST purposes)[6]. Some technical issues are so difficult the Commissioner has resorted to issuing rulings expressly stating the analysis does not apply to TLP's and leaving a void as to how TLP's are treated on the issue[7].

The practical difficulties include when is something supplied by the co-owner and when is it supplied by the TLP. How far does the "deeming" apply?

To take a very simple and very common example, if co-owner A sells its 50% share in land co-owned with B, to a third party C, how is the transaction treated for GST purposes? Legally, it is a sale from A to C of a 50% interest in the land, but for GST...

- Does A sell a 50% interest in the property to C?
- Does the A/B TLP sell a 50% interest in the property to C?
- Does A sell a 50% interest to the new B/C TLP?
- Does the A/B TLP sell the whole interest in the property to the new B/C TLP?
- Does A sell its "interest in a partnership" to C? Or A/B to C, etc?

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[4] Question 2.2 asks: Are any changes needed to the current treatment of tax law partnerships as entities to ensure that the GST law operates effectively? if so, what changes should be made"

[5] The Commissioner's view is that a TLP can have assets but does not have capital (refer GSTR 2004/6, paragraphs 99-108)

[6] Refer Reg 40-5.09(3), Item 10

[7] Refer GSTR 2008/D2 General law partnerships & the margin scheme; and GSTR 2008/D3

The answer determines who (if anyone) is liable for the GST, who can claim the credits and impacts the analysis for special rules such as supplies of a going concern or margin scheme sales. All parties (A, B and C), their advisers and the ATO need to agree on the answer in order to make sure the legal obligations, payments and invoices correctly reflect the GST liabilities and entitlements[8].

This would be difficult enough without the added complexity of the Commissioner issuing a public ruling that allows for certain TLP's not to register for GST purposes and for the co-owners to submit the relevant GST and claim the relevant input tax credits[9]. Whilst the ruling has allowed a practical compliance approach for large property co-owners, the ruling has created a hybrid system where it can be very difficult for the taxpayers, their advisers and the ATO to determine whether certain co-owners are, or are not "enterprise TLP's"[10].

The Commissioner has had difficulties with straightforward input tax credit claims with general law partnerships[11], the hybrid system for TLPs and the potential for differing views on its application will only be compounded if a dispute arises as to who is liable for GST or entitled to input tax credits.

Given these difficulties – that arise on common and regular transactions – we submit that there will be more certainty and efficiency (and less disputes) where the GST liabilities, entitlements and compliance obligations are dealt with by the co-owners.

[8] Needless to say, trying to get three separate advisers and the ATO to agree on anything is a lengthy and costly process for taxpayers

[9] Refer GSTR 2004/6 which makes the "distinction" between "enterprise TLP's" and "non-enterprise TLP's".

[10] In our experience this has arisen in audit contexts, even where no net GST revenue is at stake.

[11] Refer the facts in Deputy Commissioner of Taxation v De Angelis [2008] SADC 103.

3 Tax invoices can be issued to any group member

3.1 Issue

With reference to the Board of Taxation's questions 1.8 and 2.4[12], tax invoices for acquisitions made by a member of a GST group that are issued to another member of the GST group do not, in the absence of an express agency relationship, allow claims for an input tax credit despite the GST group holding an otherwise valid invoice..

3.2 Proposed Solution

We recommend that the GST grouping rules expressly allow that tax invoices for acquisitions made by a member of a GST group can be issued to any member of the GST group.

3.3 Analysis

Under section 29-10(3), an entity is not entitled to claim an input tax credit on its BAS until it holds a valid tax invoice for the acquisition.

In relation to acquisitions made by a member of the GST group, it is not uncommon for the tax invoice to be issued by the relevant supplier to another member of the GST group (e.g. the representative member).

This may be the case where:

- the suppliers' systems are set up to invoice the head entity of a group rather than each subsidiary;
- infrequent suppliers issue invoices to the well known head entity or its trading name (eg. Telstra, Commonwealth Bank).

In this case, the representative member of the GST group would only be able to claim the input tax credit on its BAS provided that the member named on the invoice is acting as the group member's agent in respect of the acquisition (section 153-5). Based on the Commissioner's views on GST and agency in GSTR 2000/37, the parties would need to establish the existence of such agency relationship before an input tax credit could be claimed.

We submit that it would be more practical and efficient to allow a tax invoice for an acquisition by a member of a GST group to be issued to any member of that group. To have a specific legislative provision allowing this would remove the need for group members to specifically document such an agency relationship.

In our view, such a position would be consistent with:

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[12] Questions 1.8 and 2.4 ask: Do the GST invoice and adjustment note requirements add additional compliance costs to the normal commercial invoice requirements? If so, how can those costs be minimised?

Do the rules for:

- forming, operating, altering and dissolving a GST group, a GST religious group, a GST joint venture and a GST branch; and
- reporting their GST liabilities and entitlements

achieve an appropriate balance between providing flexibility, minimising compliance costs and ensuring the integrity of the GST system? If not, how should they be modified?]

- the fact that members of a GST group are generally able to (and indeed often) act on behalf of one another given the strict “membership requirements” of GST grouping; and
- the “single entity” concept in section 48-55, which treats the GST group as a single entity for the purposes of working out the amount of input tax credits to which the representative member is entitled.

4 Grouping / de-grouping mid tax period to be allowed

4.1 Issue

With reference to the Board of Taxation's question 2.4[13], there are difficult practical and compliance issues arising under the current GST grouping rules which require the date of effect of revocation or approval of GST group membership to only be at the beginning of a tax period applying to members of the GST group.

4.2 Proposed Solution

We recommend that the GST grouping rules be amended so that the date of effect of revocation or approval of GST group membership is the date from which an entity satisfies or no longer satisfies (as the case may be) the GST grouping membership requirements.

4.3 Analysis

Under section 48-85(3) of the GST Act, the date of effect of the approval or revocation of GST group membership must be the beginning of a tax period applying to the members of the GST group in question[14].

For example, if Company A (which is a member of the ABC GST Group) was sold on 15 September 2008, the date of effect of revocation of the Company A's membership of the ABC GST group will be taken to be 1 September 2008. In this case, any supplies made between Company A and other members of the ABC GST Group between 1 September and 15 September will not be supplies made between members of a GST group.

In our view, this causes practical difficulties as supplies which would otherwise be supplies between GST group members and which are essentially ignored for GST purposes would need to be brought to account for GST purposes (assuming the supplies were taxable supplies). That is, group members would need to account for any supplies made between them from the beginning of the tax period to the date of completion. This gives rise to additional administrative requirements for taxpayers for little (if any) net revenue[15].

The absurdity of this position is highlighted by ATO ID 2004/692 which states that where an entity is sold *one minute before midnight* on the last day of a tax period applying to all group members, the date of effect of revocation can be the beginning of the following tax period. The comments contained in that ATO ID suggest that where the entity was sold at 10am on the last day of the tax period, the date of effect of revocation could not be the beginning of the following tax period. In our view, this is an odd result.

Another common example is where an company comes into existence during a tax period (say on the 5th of a month). This company, even though 100% owned from its first day, cannot join the GST group until the first day of the next tax period. This creates additional

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[13] Question 2.4 asks: Do the rules for:

- forming, operating, altering and dissolving a GST group, a GST religious group, a GST joint venture and a GST branch; and
- reporting their GST liabilities and entitlements

achieve an appropriate balance between providing flexibility, minimising compliance costs and ensuring the integrity of the GST system? If not, how should they be modified?]

[14] Unless an "annual tax period" or "instalment tax period" applies to members of the GST group.

[15] Assuming the entity making the acquisition would be entitled to a full input tax credit

administration through an extra BAS and recognising supplies and acquisitions with group members.

We recommend that the GST grouping rules be amended to allow the date of effect of GST grouping or GST de-grouping to be within a tax period. In our view, such rules should be based on the ability of the relevant GST group member's ability to satisfy the GST group membership requirements up until a particular date (e.g. the date of change of ownership) rather than for the entire tax period.

We note that such an approach would be consistent with the timing rules under the income tax consolidations regime.

However, it is very difficult to determine this from the current extremely complex grouping rules for trusts and partnerships in the interaction of Division 48 of the GST Act and Regulation 48 of the GST regulations.

On the basis that the stapled entities are a single economic and reporting entity, the companies and trusts in the stapled entity, and any 100% subsidiary companies and trusts, should be able to form a GST Group and we suggest the simple principle stated at 14.2 above should be used as the new grouping rules.

5 GST Grouping: Allow all stapled entities to form a GST group

5.1 Issue

With reference to Board of Taxation question 2.4[16], currently the rules for forming GST groups with trusts (and partnerships) are far too complex and they are also too inflexible to allow economic groups such as stapled entities to form a GST group.

5.2 Proposed Solution

The rules need to be simplified and allow all stapled entities to form a GST group.

In line with consultations that have already occurred with Treasury in late 2006 and early 2007[17], we recommend that the grouping rules for companies partnerships and trusts to be simplified to:

> "Companies, partnerships and trusts that are 90% owned (directly or indirectly) by the same individuals, family members of those individuals or stapled security holders can form a GST group"

5.3 Analysis

A "stapled entity" is a single ASX reporting entity made up of two or more legal entities which have 'stapled' their respective securities (shares and/or units) so that their security holders (ie. shareholders or unit holders) can only hold and trade the relevant securities together.

The Australian Stock Exchange (**ASX**) website defines a stapled security as being:

"A stapled security is where investors own two or more securities which are generally related and bound together through one vehicle. Typically, stapled securities consist of one trust unit and one share in the funds management company that cannot be traded separately."[18]

The ATO has also defined a stapled security as being "*created when two or more different things are contractually bound together so that they cannot be sold separately. Many different types of securities can be stapled together.*"[19]

A number of entities listed on the ASX are listed as stapled securities. These entities include, but not limited to, Westfield, Multiplex, GPT, Stockland, Australand, Macquarie Goodman Group and Mirvac. Of the listed managed investment companies and trusts on the ASX, 43 of these entities are stapled securities.[20] Although the majority of these entities consist of stapling a company share with a unit in a unit trust, it is also possible

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[16] Question 2.4 asks: Do the rules for:

- forming, operating, altering and dissolving a GST group, a GST religious group, a GST joint venture and a GST branch; and
- reporting their GST liabilities and entitlements

achieve an appropriate balance between providing flexibility, minimising compliance costs and ensuring the integrity of the GST system? If not, how should they be modified?

[17] Refer, as appropriate, to Treasury's confidential Discussion Paper: GST Grouping Principles – Membership Requirements and subsequent consultations and submissions.

[18] http://www.asx.com.au/investor/lmi/how/LMIStapled.htm

[19] http://www.ato.gov.au/individuals/content.asp?doc=/content/48455.htm

[20] http://www.asx.com.au/investor/lmi/tools/research.htm#Property_Trusts

that units in two or more separate trusts may also be stapled or a company and two or more trusts.

As a result of entities stapling their securities, the interests in the relevant company/ies and the trust/s are wholly owned by the same security holders. These security holders own both a share in the company and hold a unit in the trust (or units in both trusts if two trusts). The security holders can only sell/buy/trade the stapled security as the share(s) or unit(s) that comprises the staple cannot be sold separately by the holder.

Currently it is possible to form a GST Group including a stapled company and trust, but not a stapled trust and trust. There also difficulties if the stapled trust is the 100% owner of a downstream company rather than the stapled company.

6 Financial acquisitions threshold: increase & redefine threshold

6.1 Issue

With reference to the Board of Taxation's question 2.13[21], the financial acquisitions threshold (**FAT**) in Division 189 of the GST Act does not operate efficiently as the threshold is too easily breached and captures certain supplies that, ideally, should not be captured.

6.2 Proposed solution

The FAT could be made more efficient and effective by:

- Amending the FAT threshold so that both limbs of the threshold (i.e. greater than $50,000 and greater than 10% of total ITCs) need to be satisfied before the FAT is breached.
- increasing both limbs of the FAT threshold (e.g. $100,000 and 20%).
- excluding acquisitions that relate to GST-free financial supplies from the threshold.

6.3 Analysis

Entities are generally not entitled to claim input tax credits (**ITCs**) where their acquisitions relate to the making of financial supplies. However, the GST Act contains a de minimis test which seeks to ensure that the majority of entities are not denied ITCs where they make financial supplies which do not form part of their main business activities. The threshold test is known as the financial acquisitions threshold and is contained in Division 189 of the GST Act.

Division 189 contains a threshold test which allows full credits for an entity if its acquisitions do not exceed certain value and percentage thresholds. If the threshold is exceeded for either current or future acquisitions, the entity will not be entitled to ITCs on acquisitions to the extent that they relate to the making of input taxed financial supplies[22].

To determine whether an entity exceeds the FAT for a particular month based on the 'current acquisitions' test, the entity is required to assume that all the financial acquisitions[23] that it makes or is likely to make in a particular month are made solely for a creditable purpose. The entity will exceed the FAT during a particular month if either of the following would apply:

- the amount of all the ITCs to which the entity would be entitled for its financial acquisitions would exceed $50,000 or such other amount specified in the GST regulations[24] (**first limb**); or
- the amount of the ITCs to which the entity would be entitled for its financial acquisitions would be more than 10% of the total amount of ITCs to which it would be entitled for all its acquisitions and importations (including the financial acquisitions) during that 12 months (**second limb**).

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[21] Question 2.13 asks: Does the financial acquisitions threshold operate effectively and minimise compliance costs for affected taxpayers? If not, what changes should be made to simplify it and reduce compliance costs?

[22] Unless the acquisition is a "reduced credit acquisition" or another exception applies (eg. the borrowing exemption).

[23] Defined in section 189-15 as an acquisition that relates to the making of a financial supply (other than a financial supply consisting of a borrowing)

[24] No other amount is currently specified

It is submitted that both the first and second limbs of the threshold are too low and therefore are breached too easily. This undermines their use and effectiveness. In particular, the 'greater than 10%' test under the second limb would almost always be breached by smaller financial services businesses and most small businesses on listing.

For example, assume that a property fund makes $11,000 worth of financial acquisitions out of a total of $88,000 of acquisitions. Although the fund would not breach the first limb (as the input tax credits for its financial acquisitions are only $1,000), it would breach the second limb of the threshold as the ITCs for its financial acquisitions as a proportion of the ITCs for its total acquisitions would exceed 10% - in this case it would be 12.5% ($1,000/$8,000). In this case, given the fund has only incurred a small amount of GST in relation to its financial acquisitions (i.e. $1,000), it is submitted that the fund should not be required to consider complex apportionment compliance issues.

As such, it is suggested that the FAT test be changed so that entities are required to satisfy both the first limb and the second limb. This would make the FAT a more truly effective threshold and allow businesses that only make a small amount of financial acquisitions to claim input tax credits in full as was the original intention of the provisions.

In any event, we submit that the amount of the thresholds should be increased given that it is almost 10 years since the thresholds were first introduced. We note that since the introduction of the GST, there have been increases to other thresholds in the GST Act in line with increases in CPI and business activity etc (e.g. registration turnover threshold, cash basis accounting threshold and tax invoice requirement thresholds).

Finally, we submit that the definition of 'financial acquisition' should exclude acquisitions which relate to 'GST-free supplies'. 'Financial acquisition' is defined in section 189-15 as "an acquisition that relates to the making of a financial supply (other than a financial supply consisting of a borrowing)". A GST-free financial supply (e.g. the issue of shares to a non-resident) is, strictly speaking, still a "financial supply" despite section 9-30(3) which states that the GST-free treatment overrides the input taxed treatment. As such, acquisitions that relate to the making of GST-free supplies are included in the FAT calculations despite relating to offshore activity and giving rise to full ITCs. We submit that this is an "anomaly" with the FAT and acts as a potential disincentive for the export of goods and services from Australia.

7 Adjustment thresholds: Simplify & increase Division 129 thresholds

7.1 Issue

With reference to the Board of Taxation's question 3.3[25], we submit that the thresholds contained within Division 129 are too complex and too low.

7.2 Proposed Solution

The thresholds within Division 129 should be:

1. Simplified to a single set of thresholds by removing the distinction between "business finance" acquisitions and non "business finance" acquisitions; and
2. Increased to reduce the compliance burden for all taxpayers;

We submit that there should only be one set of thresholds and that the current thresholds be increased as follows:

Old Thresholds		New Proposed Thresholds
Business finance Acquisitions	Non-business finance acquisitions	All acquisitions
$10,000 - $50,000 – 1 yr	$1,000 - $5,000 – 2 yr	$10,000 - $100,000 – 1 yr
$50,000 - $500,000 – 5yrs	$5,000 - $500,000 – 5 years	$100,000 - $1,000,000 – 5 yrs
$500,000 and above – 10 years	$500,000 and above – 10 years	$1,000,000 and above – 10 years

7.3 Analysis

Division 129 contains two sets of thresholds. Section 129-10 provides that adjustments under Division 129 will not be required where:

- an acquisition relates to business finance unless the acquisition had a GST exclusive value of more than $10,000,
- an acquisition that does not relate to business finance, unless the acquisition had a GST exclusive value of more than $1,000.

The second threshold relates to the adjustment periods. Where the acquisition relates to business finance the relevant adjustment periods are:

- if the GST exclusive value of the acquisition is $50,000 or less – only one adjustment period;
- if the GST exclusive value of the acquisition is more than $50,000 and less than $500,000 – five adjustment periods;
- if the GST exclusive value of the acquisition is more than $500,000 – ten adjustment periods.

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[25] Question 3.3 asks: Are the adjustment threshold amounts, the number of thresholds and the timing of adjustments appropriate? Do they reflect an appropriate balance between accuracy and compliance costs? If not, how would they be modified?

Where the acquisitions do not relate to business finance, the relevant adjustment periods are:

- if the GST exclusive value of the acquisition is $5,000 or less – only two adjustment periods;
- if the GST exclusive value of the acquisition is more than $5,000 and less than $500,000 – five adjustment periods;
- if the GST exclusive value of the acquisition is more than $500,000 – ten adjustment periods.

Both the current and former Governments have attempted to reduce the burden of GST compliance. The former Government, in an attempt to "make it easier for small businesses to meet their tax obligations"[26] increased the GST registration thresholds and increased the thresholds relating to tax invoices. The current Government has also stated that it wants to "…save business, particularly small business, time and money…"[27]

As a result, we would submit that one way for the compliance of businesses, both small and large, to be reduced would be to increase the adjustment thresholds within Division 129. At a minimum, if the thresholds were doubled, the compliance burden on all entities would be reduced.

[26] The Treasury Press Release No 038 "Simpler Tax for Small Business" http://www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2007/038.htm&min=phc

[27] Assistant Treasurer Press Release No. 41 "Government Acts to reduce GST compliance costs for Business" http://assistant.treasurer.gov.au/DisplayDocs.aspx?pageID=003&doc=../content/pressreleases/2008/041.htm&min=ceb

8 Division 129 adjustments & the five year rule for new residential premises

8.1 Issue

With reference to the Board of Taxation's question 3.3[28], there is uncertainty and potential mismatch between the five year leasing period in section 40-75 after which sales of new residential premises will not be subject to GST and the adjustment periods in Division 129 which would enable input tax credits to be claimed (or require them to be repaid) depending on whether the sale of residential premises was taxable or not.

8.2 Proposed Solution

The 'five year' period in section 40-75 should be replaced with the "five adjustment periods" in Division 129 to simplify the interaction between the two provisions.

8.3 Analysis

Subsection 40-75 defines "new residential premises" and also provides that premises will not be new residential premises where they have been used to make input taxed supplies for at least five years. As a sale after this period would be input taxed, then the adjustment provisions in Division 129 will require the developer to repay all its input tax credits (subject to the thresholds) at the adjustment period after those five years, as from that time onwards it can only use the premises to make input taxed supplies.

The five year rule under 40-75 superficially appears to align with the five adjustment period threshold for Division 129. This makes sense in that it gives a clear borderline for a developer to know when it will be entitled to credits but be liable for GST on the sale or have to repay credits but not be liable to GST on the sale. However in practice, there are interpretation issues regarding when the five year period of leasing starts and ends and the "five adjustment periods" run from the time of acquisition of construction costs not from completion of the building (and may be a period of up to 5 years and 11 months).

We recommend that the 'five year' period in the section 40-75 be replaced with the "five adjustment periods" in Division 129. In this way:

- if the taxpayer sold the new residential premises within 5 years (i.e. five adjustment periods) then supply of the new residential premises would be a taxable supply and the taxpayer would be entitled to input tax credits (eg. to the extent of the revenue received for the sale over the total revenue for the sale and lease of the premises);
- if the residential premises were sold after 5 adjustment periods, whether leased for five years or not, the sale would be input taxed and input tax credits repaid under Division 129.

This has the benefit of:

- removing the current uncertainty as to whether premises need to be continuously leased or not, and whether "solely used" allows for other applications which do not result in a supply.
- simplification of the interaction between section 40-75 and Division 129;

[28] Question 3.3 asks: Are the adjustment threshold amounts, the number of thresholds and the timing of adjustments appropriate? Do they reflect an appropriate balance between accuracy and compliance costs? If not, how would they be modified?

- remove disincentive for developers to move stock into the rental market as well as simplify their compliance burden.

9 Division 135: Remove unintended consequences

9.1 Issue

With reference to Board of Taxation question 3.4[29], there are unintended interactions with the operation of Division 135 in its application to supplies which would otherwise have been non-taxable as it gives rise to an increasing adjustment in circumstances where no GST was (or should be) payable.

This is contrary to the express policy behind Division 135 (refer Explanatory Memorandum quoted below).

9.2 Proposed Solution

A proposed solution to this anomaly would be for Division 135 and Subdivision 38-J to only apply to the extent that the supplies of the going concern would have been taxable. This would ensure that if the going concern was acquired to make input taxed supplies, a Division 135 adjustment would still arise but only to the extent GST would have been payable on the supply.

9.3 Analysis

Division 135 of the GST Act provides that where you acquire a going concern or acquire GST-free farmland you will have an increasing adjustment where that supply relates to making supplies that are neither taxable supplies or GST-free supplies.

The rationale of Division 135 is that the acquiring entity would not have been entitled to input tax credits had the supplies been taxable, so the increasing adjustment places the entity in the same position that it would have been had the supply not been a GST-free supply. This rationale is clearly set out in the paragraph 6.256 of the Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998* (the **EM**):

> "Division 135 provides for an adjustment to ensure that you account for GST in proportion to the private or input taxed use of a going concern that you acquire. The adjustment increases your net amount by an amount equal to the GST you would bear on the acquisition if it had been a taxable supply to you. **The adjustment is equivalent to the difference between what would have been the GST on the supply and the input tax credit you would have been entitled to for the acquisition if the supply had been a taxable supply.** This is the effect of section 135-5.
>
> [emphasis added]

The application of Division 135 follows the same approach adopted in subsection 11-15 of the GST Act which provides:

> *"However, you do not acquire the thing for a creditable purpose to the extent that:*
>
> *(a) the acquisition relates to making supplies that would be input taxed;"*

The application of both subsection 11-15(2) and Division 135 results in a taxpayer not being entitled to input tax credits where those acquisitions are used by the acquirer to make input taxed supplies.

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[29] Question 3.4 asks: There are many different adjustment provisions in the GST Act. Are there any unintended circumstances that arise due to the interaction of the different adjustment provisions with one another and other areas of the GST law?

The anomaly with the application of Division 135 arises where a supply of a thing, which otherwise would have been input taxed or non-taxable, is supplied as part of a GST-free going concern. If the thing had been supplied as an input taxed supply, no GST would be payable so no input tax credits would arise. However, where the same thing is supplied as a GST-free supply of a going concern and the taxpayer subsequently uses the thing to make input taxed supplies, an increasing adjustment will arise. This could arise as a result of a supply of a leasing enterprise involving residential premises that are not new residential premises.[30]

Although the EM provides that Division 135 should apply to ensure that the adjustment is equivalent to the GST on the supply and the input tax credit you would have been entitled, where an input taxed supply is supplied as part of a GST-free going concern, no GST arises on the supply and no input tax credit would have arisen. As a result, the increasing adjustment reflects an amount of GST that would never have had to have been paid had the supply been made in a way other than as a supply of a going concern.

As such, we would suggest that Division 135 and/or section 38-325 (the going concern provision) be revised to ensure that where supplies that are otherwise not taxable or GST-free supplies are supplied as a going concern, no adjustment should arise as no input tax credits would have been claimed had the supplies been made in a way other than as a GST-free supply of a going concern.

[30] The Commissioner has determined in ATO ID 2002/709 that the supply of a block of residential flats that were leased could satisfy the requirements of a GST-free supply of going concern. ATO ID 2002/710 provides that where residential flats have been supplied as a GST-free going concern, Division 135 will apply to the acquisition resulting in an increasing adjustment where it has been acquired to make input taxed supplies.

10 Adjustment Provisions: Symmetrical decreasing adjustment for non-margin scheme sales

10.1 Issue

With respect to the Board of Taxation's question 3.6[31], an adjustment provision is needed to allow a decreasing adjustment for the input tax credit previously denied on an acquisition under the margin scheme where the subsequent supply is not under the margin scheme. Such a provision would provide symmetry to the increasing adjustment provision, section 75-22, inserted in 2005.

10.2 Proposed Solution

We propose that the solution is as simple as a new provision – ie section 75-23 – setting out the entitlement to the decreasing adjustment.

10.3 Analysis

Currently an entity is liable for an increasing adjustment (ie. a payment of GST) if it acquires land in a fully taxable supply, claims an input tax credit and later sells the land (or part of it) under the GST margin scheme[32]. This adjustment, effectively repaying the original input tax credit, reflects the policy that no input tax credit is available for land to be sold under the margin scheme to ensure that the aggregate revenue is the GST payable by each land owner on its margin.

However, there is no mirror provision to allow a decreasing adjustment where an entity acquired land under the margin scheme but subsequently sold part or all of the land in a fully taxable supply (or, potentially, a GST-free supply or a taxable leasing of the land). In these circumstances, there is a cascading of GST on the non-margin scheme supplies, which is contrary to the policy.

The circumstances of acquiring under the margin scheme and later selling or leasing in a taxable or GST-free supply could arise where an entity acquires a site for "mixed use" development, for example:

- a very large tract of land for residential development but which will include a shopping centre;
- a single "mixed use" development such as an apartments, hotel and offices; and
- a retirement village which includes residential living units and GST-free aged care.

[31] Question 3.6 states: Do the adjustment provisions cover all transactions where an adjustment should be available? Are there any other issues or anomalies with the adjustment provisions that need to be addressed? If so, what changes are needed?

[32] The margin scheme is not normally available where the same land is acquired in a fully taxable supply as is being sold, but where the land is acquired and amalgamated with other land that is eligible to be sold under the margin scheme, then the entire amalgamated title is able to be sold under the margin scheme subject to the section 75-22 increasing adjustment.

11 Correcting Mistakes: Increase correction thresholds

11.1 Issue

With reference to the Board of Taxation's question 3.7[33], the current administratively imposed threshold for correcting GST mistakes is arbitrary and relatively onerous for large taxpayers. When the mistakes exceed the current, low GST correction limits, the revision of the relevant Business Activity Statements can be time consuming and focuses the taxpayer on historical action rather than focusing on how to minimise future mistakes and compliance with their GST requirements.

11.2 Proposed Solution

Increase both the correction and time limits for correcting GST mistakes where taxpayers have made honest mistakes in calculating their BAS.

We would suggest the thresholds should be (at least):

Turnover	Proposed New Time limits	Proposed New Correction limits
Less than $20m	Up to 18 months (remains the same)	Less than $50,000
$20m to less than $100m	Up to 6 months	Less than $100,000
$100m to less than $500m	Up to 6 months	Less than $250,000
$500m to less than $1b	Up to 6 months	Less than $500,000
$1b and over	Up to 6 months	Less than $1,000,000

11.3 Analysis

Currently there is only one specific section in the GST Act which deal with the process for correcting GST mistakes. Section 17-20 of the GST Act provides the Commissioner with limited power to make a determination as to how errors in the "immediately proceeding" tax period can be taken into account in the current period.

The Commissioner has issued the fact sheet "Correcting GST mistakes." The fact sheet notes that the Commissioner accepts that mistakes can be genuine and occur in the normal course of business and therefore provides that certain mistakes can be corrected in the current period where both the time and correction limits are not exceeded.[34] The correction limits imposed by the Commissioner correspond to the size of the taxpayer.

First, we note that the Commissioner using his general power to allow for certain mistakes to be rectified in a current BAS rather then amend previous BASs, is a welcome administrative relief for taxpayers.

Difficulties arise with the Commissioner's fact sheet where the correction and time limits are exceeded. For example, a mistakes discovered after the three month time limit has been exceeded or exceeding the thresholds that are relatively low as a percentage of turnover.

Revising past BASs can be time consuming and administratively onerous because:

[33] Question 3.7 asks: Does the process for correcting GST mistakes encourage taxpayers to accurately determine their liability, whilst imposing the lowest practical compliance costs? Is there a need to change the operation of the law with regard to correcting GST mistakes to meet the above objectives? If so, what changes should be made?

[34] The Board of Taxation notes in the Issues Paper that the Commissioner has relied upon section 255-10 of Schedule 1 of the *Tax Administration Act 1953* (TAA) and section 356-5 of Schedule 1 of the TAA to issue the fact sheet.

- it amounts to a voluntary disclosure each time, which often means external advisors are asked to review the issue;
- if other parties are involved, which is usually the case with GST corrections, they need to be consulted (and sometimes they also consult their advisors, further extending the time and cost);
- the revision may also create time consuming queries from the Commissioner.

We submit that these correction and time limit thresholds should be increased, especially for compliant taxpayers who have made honest mistakes in the calculation of their net amount. These taxpayers should not be limited to correcting only those honest mistakes that fall within the correction limits. On discovering an error, a taxpayer may need to review the background surrounding how the error arose and whether it was made in subsequent or preceding submitted BAS. The time required to review the surrounding background, depending on other work commitments arising from the normal course of business, may take longer than the 3 month period allowed by the fact sheet. Although there may be no intent in delaying the rectification of the mistake, where the three month period is exceeded, the taxpayer may no longer be entitled to rely on the fact sheet and will still need to revise the BAS that were incorrect.

As such, we would suggest that both the correction and time limits currently contained in the Commissioner's fact sheet, should at least be doubled. We would further suggest that for entities with a turnover of greater than $1 billion, the correction limit be increased to at least $1 million. These increased limits would allow for mistakes to easily be corrected by taxpayers and would allow taxpayers time to review how the mistakes initially arose.

12 SIC for GST and symmetry with interest on overpayments

12.1 Issue

With reference to the Board of Taxation's question 4.15[35], there are circumstances where a "SIC-like" charge would be much more appropriate for GST than the current GIC regime.

12.2 Proposed Solution

A "SIC-like" charge could be appropriate in where the Commissioner undertakes an audit and determines that the taxpayer has a shortfall amount.

Further, automatic remission to at least the base rate should be applied where the taxpayer voluntarily revises a BAS which creates a shortfall amount from the original BAS submission.

12.3 Analysis

Currently a taxpayer is only liable for shortfall interest charge (SIC) where an amount of ***income tax*** is payable as a result of an assessment being amended for an income year. The SIC rate on this amended assessment is only 3 percentage points above the base interest rate as compared to the GIC rate which is 7 percentage points above the base interest rate.

Under the Taxpayers' Charter the Commissioner generally considers that most taxpayers act in honest manner, as such, applying a SIC-like charge may be more appropriate than the higher GIC amount. It would indicate that the Commissioner acknowledges that mistakes can occur, but the Commissioner would still not be "out of pocket" from such a mistake.

We would suggest that a "SIC-like" charge could be appropriate for GST purposes situations where the Commissioner undertakes an audit and determines that the taxpayer has a shortfall amount.

Where the Commissioner reviews a BAS and determines that the net amount is incorrect, the Commissioner could issue a GST assessment (although this may not necessarily need to be a requirement) and a "SIC-like" charge could apply to the difference between the amount determined by the taxpayer and the amount determined by the Commissioner rather than the GIC. This would still encourage taxpayers to correctly determine their GST liability prior to the submission of each BAS. Like SIC and GIC, the charge would apply regardless of whether the taxpayer was liable for an administrative penalty.

Further, in order to encourage voluntary disclosures before audit action commences, which will assist the Commissioner in administering the GST regime, the GIC on voluntary disclosures should only be a maximum of the base rate (the taxpayer should still be entitled to request the Commissioner's discretion to remit the charge if the circumstances are appropriate).

Both scenarios, SIC for audits and general rate for voluntary disclosures, still encourage taxpayers to comply with the provisions of the GST Act, but distinguishing voluntary disclosures provides incentives for the taxpayer to comply with the land .

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[35] Question 4.15 asks: Are there circumstances in which a "SIC-like" charge would be appropriate for GST? How could this work given that usually there is no GST assessment?

13 Partitioning: transfers on partitioning should be ignored for GST purposes

13.1 Issue

The issue for GST purposes is whether a partition by agreement, where each co-owner's interest remains equal, should result in a taxable supply for GST purposes.

Based on the wide definition of "supply" in the GST Act, partitioning is likely to result in supplies being made between the parties[36]. However, it is merely a change of legal interests for no monetary consideration, which is ignored for stamp duty purposes, and recognising it as a supply for GST purposes will create very complex accounting for GST margin scheme sales for little (if any) net revenue.

13.2 Proposed solution

We submit that supplies by way of partition should be ignored for GST purposes and expressly set out as an exclusion to what is a "supply" as a new sub-paragraph in section 9-10(4).

13.3 Analysis

Partitioning occurs where the joint ownership of real property (i.e. between joint tenants or tenants in common) is terminated by the division of land between the co-owners. The partitioning of land may occur by way of agreement between parties or through a court order. Relevantly for property developers the division of the property where interests remain the same does not give rise to stamp duty (see for example, section 30 of the *Duties Act 1997 (NSW)*).

By way of example, in a partition a co-owner may start with a 50% interest in the whole land (50% in 100%) and after partitioning ends with a 50% interest in a separately-titled part of the land (100% in 50%).

We submit that ignoring supplies by way of partition for GST purposes would remove the significant complexities for taxpayers particularly in relation to the complicated margin scheme calculations required where:

- there are more than 2 co-owners, more titles, and differently valued interests;
- part of the land is to be supplied under the margin scheme and the other part to be supplied under the normal GST rules;
- the co-owners involve general law partnerships or tax law partnerships (noting our submission in section 2 that TLPs is not deemed to be entities for GST purposes); and
- the supplies relate to acquisitions of land by unregistered parties.

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[36] which is the preliminary view expressed by the Commissioner in Draft GST Ruling GSTR 2008/D3

14 Land value increase while held by unregistered entity not to be taxed

14.1 Issue

Currently, the margin scheme provisions of the GST Act do not tax the increase in the value of land held by an unregistered entity – unless and until the entity registers for GST in which case a valuation of the land as at the date of registration is required. However, these provisions, Item 2 of section 75-10(3)(b), only apply if the entity acquired the land before 1 July 2000. If the land is acquired after 1 July 2000 by an unregistered entity, the margin scheme provisions will tax the increase in value of the land while the entity is not registered for GST.

14.2 Proposed Solution

This anomaly can be simply fixed by amending Item 2 of Section 75-10(3) (b) as follows:

> *The supplier acquired the interest, unit or lease before it became *registered or *required to be registered*

14.3 Analysis

It is the clear policy of the margin scheme provisions to tax the value added to land by registered entities after 1 July 2000[37].

If an entity held land on 1 July 2000, registers for GST sometime after that date and sells the land under the GST margin scheme, then the "margin" for GST purposes under Item 2 of section 75-10(3)(b) is the difference between the selling price and the value of the land as at the date the entity registered for GST. This ensures the increase (if any) in the value of the land between 1 July 2000 and the date of registration is not subject to GST.

However, an anomaly arises where an unregistered entity acquires land after 1 July 2000, later registers for GST and then sells under the margin scheme. The current wording of Item 2 of section 75-10(3)(b) would not apply to such an entity, as it did not hold the land as at 1 July 2000, so the "margin" for this entity is the difference between its selling price and its purchase price. This means the increase (if any) in the value of the land between the date it was acquired and the date of registration <u>is</u> subject to GST.

This anomalous situation, where the value increase of land held by an unregistered entity is taxed, may arise (and indeed has arisen) where, for example, a 'mum and dad' home owner of a large block decide to use the land in a property development enterprise.

[37] Refer Sterling Guardian Pty Limited v Commissioner of Taxation [2005] FCA 1166, Brady King Pty Ltd v Commissioner of Taxation [2008] FCAFC 118

15 Approved form for Division 105

15.1 Issue

Taxpayers have difficulty with what is required by the term "reasonable information" in section 105-5(3)(b) of the GST Act.

15.2 Proposed Solution

We recommend that there be a specific mechanism in the GST Act which prescribes an "approved form" for the purposes of Division 105, which outlines what sort of information would be regarded as "reasonable" in order to determine whether the supply (if made by the debtor) would have been a taxable supply.

15.3 Analysis

Under Division 105 of the GST Act, the supply of property by a mortgagee in possession will be a taxable supply if the supply would have been taxable had the debtor made the supply. However, the supply is not a taxable supply if:

- the debtor has given a written notice stating that the supply would not have been a taxable supply if the debtor were to make it; or
- if such notice cannot be obtained, the mortgagor believes on the basis of reasonable information that the supply would not have been a taxable supply if the debtor were to make it.

If a written notice cannot be obtained from the debtor, the issue that arises is what constitutes "reasonable information" and, in particular what the ATO regards as reasonable information. Based on our understanding from taxpayers that have been affected, the ATO applies this provision very strictly and the burden of proof for mortgagees in not treating the supply as taxable is extremely high. Further, in our experience, the ability of mortgagees to obtain the requisite information from debtors in these circumstances is limited given the tenuous relationship between the debtor and mortgagee (as the loan is in default).

Further, where the relevant property is residential premises, perhaps there should be a legislated assumption that its supply would not be taxable as the sale of residential premises that are not newly constructed is input taxed.

16 The "borrowing exemption": remove debt v equity distinction

16.1 Issue

The "borrowing exemption" under section 11-15(5) of the GST Act is too narrow and discriminates between different forms of capital raising activities, namely debt and equity.

16.2 Proposed solution

We recommend that the exemption in section 11-15(5), which currently only applies to "borrowings", should be broadened to include other forms of capital raising activities such as issuing shares and related activities such as interest rate swaps.

16.3 Analysis

Under section 11-15(5), an acquisition is not treated as relating to making supplies that would be input taxed to the extent that:

- The acquisition relates to making a financial supply consisting of a borrowing; and
- The borrowing relates to making supplies that are not input taxed.

This provision (often referred to as the "borrowing exemption") allows entities to claim input tax credits for acquisitions that relate to borrowings which are used to finance taxable or GST-free activities.

The term "borrowing" takes its meaning from section 995-1 of the *Income Tax Assessment Act 1997*, being "any form of borrowing, whether secured or unsecured, and includes the raising of funds by the issue of a bond, debenture, discounted security or other document evidencing indebtedness."

As such, the borrowing exemption is currently confined to a particular form of finance - essentially debt finance. We submit that the exemption should be broadened to include other forms of capital raising activities, and, in particular equity financing options such as the issue of shares. In our view, it should not matter whether debt or equity is used to finance the non input taxed activities of a business – the same GST outcome should arise. The exemption should also cover directly related financial instruments such as interest rate swaps.

It is submitted that such a change would:

- be supported by the EU VAT treatment of capital raisings. In particular, we note that in *Kretztechnik AG v. Finanzamt Linz*[38], the European Court of Justice held that the issue of shares was not a supply for the VAT purposes, thereby allowing full recovery of input tax credits. Although, we do not submit that the issue of shares is not a supply for GST purposes, we consider that the principle from *Kretztechnik* supports the availability of input tax credits for acquisitions connected to the issue of shares to fund taxable or GST-free activities.
- make Australia's financial system more competitive by allowing funding decisions to be unaffected by "anomalies" in the GST law. This would support the Australian Government's commitment to make Australia "a financial hub in the Asia-Pacific region"[39].

[38] Case C-465/03 [2005] STC 1118

[39] Refer Media Release dated 23 July 2008 by The Hon Chris Bowen MP

- be entirely appropriate given the current state of the financial markets with the US sub-prime mortgage crisis resulting in a dramatic downturn in debt as a viable means of finance for Australian businesses. Accordingly, businesses are relying more on equity finance to fund their business activities.

The anomalous distinction for the exemption in section 11-15(5) in excluding equity financing is illustrated in ATO ID 2004/902. In that Interpretive Decision, the issue was whether an entity made a 'financial supply consisting of a borrowing' when it issued convertible notes to raise capital in the course of its enterprise. Under the terms of that issue, note holders had the right to redeem the note for cash or convert it into ordinary shares at a fixed price at a specified date. In that case, the Commissioner held that the entity did make a 'financial supply consisting of a borrowing' when it issued convertible notes to raise capital in the course of its enterprise. As such, the entity would have been entitled to claim input tax credits for acquisitions which related to the issue of the convertible note under section 11-15(5) notwithstanding the fact that the entity may have ended up with shares on issue rather than notes.

It is submitted that the broadening of the exemption in section 11-15(5) would "result in reductions in compliance costs" and "improve the operation of the GST"[40].

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[40] Refer page vii of the *Review of the Legal Framework for the Administration of the Goods and Services Tax Issues Paper July 2008*